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BEFORE THE ARIZONA CORPORATION CC...

COMMISSIONERS

KRISTIN K. MAYES - Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

Arizona Corporation Commission
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| IN THE MATTER OF THE APPLICATION OF SULPHUR SPRINGS VALLEY ELECTRIC COOPERATIVE, INC. FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RETURN THEREON, TO APPROVE RATES DESIGNED TO DEVELOP SUCH RETURN AND FOR RELATED APPROVALS. | DOCKET NO. E-01575A-08-0328<br><br>DECISION NO. 71274<br><br>**OPINION AND ORDER** |

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| DATE OF HEARING: | April 21, 22, and 23, 2009 |
| PLACE OF HEARING: | Tucson, Arizona |
| DATE OF PUBLIC COMMENT: | February 11, 2009 |
| PLACE OF PUBLIC COMMENT: | Sierra Vista, Arizona |
| ADMINISTRATIVE LAW JUDGE: | Jane L. Rodda |
| IN ATTENDANCE: | Kristen K. Mayes, Chairman<br>Gary Pierce, Commissioner<br>Paul Newman, Commissioner<br>Sandra D. Kennedy, Commissioner<br>Bob Stump, Commissioner |
| APPEARANCES: | Mr. Bradley S. Carroll, SNELL & WILMER, LLP, on behalf of Applicant; and<br><br>Mr. Wesley C. Van Cleve and Mr. Kevin Torrey, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission. |

**BY THE COMMISSION:**

Background

Sulphur Springs Valley Electric Cooperative, Inc. ("SSVEC" or "Cooperative") filed an application for a rate increase with the Arizona Corporation Commission ("Commission") on June 30, 2008. SSVEC is a member owned non-profit cooperative that provides electric distribution services to approximately 51,000 customers in Cochise, Santa Cruz, Pima and Graham Counties, Arizona.

The hearing in this matter commenced on April 21, 2009, in Tucson, Arizona. In addition, the Commission conducted a Public Comment meeting in Sierra Vista on February 11, 2009.

This is SSVEC's first application for a rate increase since 1993, and the first one since SSVEC became a Partial Requirement Member ("PRM") of Arizona Electric Power Cooperative ("AEPCO") on January 1, 2008. SSVEC utilized a Test Year ended December 31, 2007. As originally filed, SSVEC sought to increase its annual revenue by $10,881,590, from adjusted Test Year revenues of $92,613,559 to $103,495,149, an 11.75 percent increase.[1] The Cooperative stated that it was requesting the rate increase in order to increase its equity by 1.5 to 2.0 percent per year to reach a 30 percent equity level by 2014/2015; increase its annual cash flow; and meet its financial objectives regarding the addition of new generation sources required by the continuing growth in its service territory.

As its final position, SSVEC requests a rate increase of $9,862,959, 10.63 percent over Test Year revenues, for a revenue requirement of $102,688,240,[2] which would yield Operating Income/Margin[3] of $16,706,387 and Net Income/Margin of $10,267,812. SSVEC's proposal results in a 12.57 percent rate of return on Fair Value Rate Base, and yields a net operating Times Interest Earned Ratio ("TIER") of 2.46 and a Debt Service Coverage ("DSC") of 2.25. SSVEC states this translates into an increase for the average residential customer of 10.46 percent.

In addition to the rate increase, in its application, SSVEC requested that the Commission: (1) approve a revision to its Wholesale Power Cost Adjustor ("WPCA") Mechanism to include the pass-through of future generation and transmission costs associated with future Cooperative-owned generation and transmission facilities;[4] (2) implement a new Debt-Cost Adjustment mechanism that

[1] Ex A-7 Hedrick Direct at 8.

[2] Ex A-9 Hedrick Rebuttal, schedule DH-10.

[3] The Cooperative and Staff refer to Operating Margin and Net Margin instead of Operating Income and Net Income, the terms are synonymous. Operating Income/Margin is Total Revenue less Operating Expenses. Net Income/Net Margin is Operating Income/Margin less non-operating expenses, such as interest, plus non-operating income.

[4] As such the Cooperative referred to the new mechanism as the Wholesale Power and Fuel Cost Adjustor ("WPFCA"), while throughout the proceeding Staff continued to refer to the WPCA. Because Staff does not oppose the expansion of the adjustor mechanism to include fuel costs if the Cooperative acquires generation assets, for uniformity the mechanism

would permit the Cooperative to recover increases in interest costs associated with Commission-approved financing of plant additions; (3) eliminate line extension credits pursuant to the Cooperative's line extension policy; (4) approve SSVEC's Demand Side Management ("DSM") Program (to the extent not already approved); (5) include a portion of approved future DSM program expenses in base rates and implement a revised DSM adjustor mechanism and approval process to recover approved DSM programs; [5] and (6) revise its Tariffs and Service Conditions. Most of the public comment in this proceeding focused on SSVEC's planned upgrade of a transmission line in the Sonoita area. Some members in the Sonoita area question the need for the new line and have sought Commission intervention to stop its construction. Thus, in addition to the issues it raised in connection with its rate application, SSVEC presented evidence and argued that the upgrade of the existing transmission line serving the Sonoita area to a 69 kV line, known as the Sonoita Reliability Project, is needed to ensure reliable service in the area.

Staff recommends a revenue increase of $7,595,316, or 8.18 percent, from adjusted Test Year revenues of $92,825,281 to $100,420,597. Staff's recommendation produces Operating Income of $15,365,515,[6] and Net Income of $8,926,940.[7] Staff's recommended revenue results in an 11.56 percent rate of return on an adjusted rate base of $132,886,202. Staff states that its recommended revenues would produce a TIER of 2.34 and DSC of 2.12. Staff claims that its recommended revenue level will increase SSVEC's equity to 30 percent of total capital by 2016, assuming the Cooperative utilizes $3 million of its Net Income to reduce its projected long-term debt levels, and assuming that starting in 2013, SSVEC will borrow 10 percent less than the Cooperative currently projects.

After discovery, the Cooperative revised its requests, and decided not to pursue its request for a Debt-Cost Adjustment mechanism or to have a portion of its DSM Program expenses included in

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will be referred to as the WPFCA when discussing the new mechanism and the WPCA when discussing the existing mechanism.

[5] Staff had originally recommended that SSVEC file a new application requesting approval of new DSM programs that it had proposed as part of this docket in order to allow an opportunity to gather information and to evaluate the new programs. SSVEC requested that the proposed programs be evaluated as part of this docket in order to have them implemented more quickly. The parties agreed that Staff would attempt to evaluate the proposed DSM programs as part of this docket and submit its recommendations as a *late-filed exhibit*.

[6] Ex S-7 Brown Surrebuttal at 2.

[7] *Id.*, Schedule CSB-8.

base rates. SSVEC and Staff have reached agreement on many issues, however, they continue to disagree about the level of revenue necessary to achieve a 30 percent equity ratio by 2016; several of Staff's adjustments to operating expenses; the process for resetting the WPFAC and the DSM Adjustor; whether a prudency review of power procurement activities should be required; and the appropriate level of the customer charge as part of the rate design.[8]

SSVEC believes that its ability to hold rates constant for 16 years and then request only a modest 10.46 percent revenue increase is something the Commission should view as a positive.[9] SSVEC argues that the Cooperative should not be viewed by the Commission as a utility that is in need of more regulatory oversight.[10] SSVEC believes that the primary issue in this rate case is its ability to build its equity to 30 percent of total capital by 2016, and it argues that Staff's recommendations would negatively affect the Cooperative's ability to meet this equity goal and should be rejected.

**Rate Base**

In its application, SSVEC proposed an Adjusted Rate Base of $136,903,293. Staff recommended adjustments that reduced rate base by $4,017,091, resulting in an Original Cost Rate Base ("OCRB") of $132,886,202. Staff's rate base adjustments primarily affected consumer deposits, deferred credits and working capital.[11] SSVEC agreed to Staff's recommended adjusted OCRB.[12]

SSVEC did not prepare a Reconstruction Cost New Rate Base, and thus, its OCRB is deemed to be its Fair Value Rate Base ("FVRB").

Staff's adjustments to the Cooperative's proposed OCRB are reasonable and should be adopted. Consequently, SSVEC's FVRB is determined to be $132,886,202.

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[8] The parties agree about the base cost of power, service conditions, and the establishment of written power procurement procedures. The design of Tie-Of-Use rates, the Bill Estimation Tariff and Tariff Changes.
[9] SSVEC Opening Brief at 4.
[10] *Id.*
[11] Ex S-6, Brown Direct at 8.
[12] SSVEC Opening Brief at 7.

**Operating Income**

Operating Revenues

The parties have agreed that adjusted Test Year revenues were $92,825,281.

Operating Expense

Staff adjusted the Cooperative's Operating Expenses, reducing them by $1,307,380, from $86,362,461 to $85,055,081.

SSVEC agreed to adopt a number of Staff's proposed adjustments to Operating Income and Expenses as follows:

No. 1 - Revenue Annualization - $303,312
No. 1 - Expense Annualization - $149,184
No. 3 - 2008 Fort Huachuca Contract - $0
No. 4 - Base Cost of Power - $10,523,837
No. 5 - DSM Expenses – ($484,966)
No. 7 - GDS Expenses – ($51,427)
No. 8 - Normalized Legal Expenses – ($52,892)
No. 11- Interest Expense on LTD – ($426,301)
No. 12 - Capital Credits – ($2,722,816)

SSVEC objects to Staff's recommended adjustments to Payroll Expense, "Incentive Pay", Charitable Contributions, and Rate Case Expense.

Payroll Expenses

Staff reduced Payroll Expenses by $523,570, from $1,021,207 to $497,637.[13] Staff removed the expenses associated with 10 employees who were hired in 2008 after the end of the Test Year.

Staff argues that it is not appropriate to include the additional 10 employees because SSVEC did not demonstrate that the number of employees in the Test Year was abnormally low. Staff argues that even if the expenses are known and measureable, there has been no showing that there was a need for the added employees.[14] Staff asserts that to include the expenses associated with the post-Test Year employees creates a matching problem and that the Cooperative's argument that the additional ten employees were needed to maintain service reliability misses the point of a Test Year.[15] In response to the Cooperative's claims that it is reasonable to include the costs associated with the additional employees because of inherent regulatory lag and that waiting to hire additional

[13] Ex S-7 Brown Surrebuttal, Schedule CSB-15.
[14] Staff Reply Brief at 2.
[15] Staff Reply Brief at 2.

staff until quality and service levels decline is not appropriate, Staff states that it is not suggesting that SSVEC wait until service quality declines before hiring, but that SSVEC should file rate cases more often than every 16 years.[16]

SSVEC argues that Staff's reduction of known and measurable post-Test Year expenses is not appropriate. SSVEC states the employees at issue were hired within four months of the end of the Test Year and remain on the payroll. SSVEC asserts that although Staff claims a matching problem is created by including these post-Test Year expenses, Staff in other areas acknowledges that it is appropriate to make proforma adjustments to reflect a reasonable expense going forward.[17] SSVEC asserts Staff's position ignores testimony by Mr. Hedrick that the payroll level proposed by SSVEC represents the level of payroll needed to provide service quality and that the Cooperative has experienced significant growth over the past five years.[18] SSVEC believes Staff's position also ignores that regardless of whether the expense is "allowed," the Cooperative will continue to pay these ten employees, which would reduce its ability to improve equity.

The Commission considers post–Test Year adjustments on a case-by-case basis, in an attempt to normalize Test Year results to reflect known and measureable changes to the Test Year. In this case, although it does not appear that the 2007 staffing levels were abnormally low or "not normal," the Cooperative has demonstrated that its requested Payroll Expense represents a known and measureable expense, as well as a continuous level of staffing. Staff believed that the employees were hired to service growth in 2008 and future years.[19] However, the Cooperative has shown that in the five years commencing in 2003, it has experienced significant growth and that growth in staffing, including the employees at issue, over the same period has grown proportionately.[20] The evidence shows that the new employees were hired in early 2008 to achieve sufficient staffing levels to maintain service quality arising from the high growth that occurred from 2003 through 2008, and were not hired to serve growth that occurred after the Test Year. The Arizona Administrative Code

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[16] Staff Opening Brief at 2-3.
[17] Citing Staff's adjustment to Interest Expense in this case to reflect an interest rate change that occurred 11 months after the end of the Test Year.
[18] Ex A-8, Hedrick Rebuttal at 8-9.
[19] Ex A-7 Brown Surrebuttal at 7.
[20] Ex A-8 Hedrick Rebuttal, Schedule DH 6.1.

allows for adjustments to actual test year results to obtain a normal or more realistic relationship between revenues and expenses and rate base.[21] In this case, the proforma adjustment reflects a realistic staffing level and a known and measureable expense.

Year End Bonus and Safety Pay

Staff's adjustments removed $45,058 from Payroll Expenses associated with expenditures that Staff characterizes as "Incentive Payments." Payments in this category comprise two components: $24,558 related to safety performance, and $20,500 related to year end bonuses. The Cooperative claims that these amounts have been consistently paid to all SSVEC employees for many years and are merely part of the entire compensation package.[22] The year-end pay represents a $100 payment to all employees made at the end of the year. Employees are entitled to safety pay for attending safety meetings and maintaining an accident-free record.[23] The average payment under the safety pay program in the Test Year was $126.

Staff states that while it is not recommending that SSVEC cease paying its employees the bonuses or safety pay, they are optional costs that should not be recovered through rates.[24] To the extent that the Cooperative recovers these costs through rates, but elects not to award the incentives, Staff states the funds would become available for other activities.[25]

Whether the Cooperative is required to pay year end bonuses or not, employees have come to expect a relatively small extra payment at the end of the year, which contributes to employee morale and satisfaction and is one factor that allows the Cooperative to retain its employees. The year end bonus is not tied to performance and is distinguishable from other situations where the Commission has not allowed the recovery of incentive pay/bonuses. Encouraging employees to attend safety meetings and maintain a safe record ultimately leads to lower costs.

Charitable Contributions

Staff reduced Charitable Contributions and Other Expenses by $298,622, from $343,752 to

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[21] A.A.C. R14-2-103(p).
[22] *Id.* at 11; Ex A-9 Hedrick Rejoinder at 4.
[23] Transcript of the April 21, 2009 hearing ("Tr.") at 289.
[24] Staff Opening Brief at 4.
[25] *Id.*

$45,150.[26] Staff removed expenditures for charitable contributions, sponsorships, gifts, and awards, meals and employee parties and entertainment.

Staff argues that charitable contributions should be disallowed because they are not needed to provide service, and the mere fact that the Commission allowed these expenses in the past does not mean that the Cooperative is entitled to recover the expense in the current case. Staff states that in other recent rate cases the Commission has disallowed charitable expenses.[27] Because the decision of how much to donate, or whether to donate at all, is entirely within the discretion of SSVEC management, Staff believes that in the absence of a mandate to provide such charitable donations, there should be no guaranteed revenue stream for those purposes.[28]

SSVEC argues that Staff's disallowance of Charitable Expenses is contrary to Decision No. 58358 (the 1993 Rate Decision) in which the Commission allowed the recovery of such expenses. SSVEC noted that with respect to Charitable Contributions, Decision No. 58358 provided:

> These expenses go to the difficult issue of the role of a Cooperative today. We are mindful of the impassioned arguments made by members of the Cooperative and its board of directors during the public comment session who said that these expenses are appropriate for SSVEC's rural community; that the activities supported may be the only ones available to young people in the area and may not otherwise take place; and, that SSVEC's support is essential for much needed economic development. Additionally, we recognize that the cost of SSVEC's support for all of these expenses averaged but $1.76 per customer per year. Were this an investor-owned-utility, we could require that the investors, not the ratepayers, bear the cost of the corporation's community mindedness. With a cooperative the ratepayers cannot be separated from their member-owners. For these reasons, we will allow the costs in the instant case. However, we share the view of RUCO and Staff that members' choices are made for them. Therefore, we will require SSVEC, in its next rate proceeding, to demonstrate that a majority of its members have ratified the Board's expenditure of their funds for these purposes. If it does not, we will disallow the expenditures. To fairly gauge its members' desires SSVEC should:
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> a. prepare a ballot for each of its members containing sufficient information to explain the expenses at issue;
> b. submit a draft of the ballot to the Director of the Utilities Division for approval/modification; such approval/modification shall be provided within 15 days of receipt;
> c. mail the approved ballot to each member; and
> d. receive the approval of a majority of the members voting

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[26] Ex S-7, Brown Surrebuttal, Schedule CSB-18.
[27] Staff Opening Brief at 3.
[28] Staff Reply Brief at 4.

and returning the ballots within 30 days of SSVEC's mailing of the ballots.[29]

SSVEC asserts that the evidence presented at the hearing demonstrates that: (1) the Cooperative initiated the by-law change in 1997, (ii) the Cooperative filed the proposed change to its by-laws with the Commission's Director of Utilities; (iii) the by-law change was submitted to the Cooperative's members and was approved by over a 90 percent margin; and (iv) SSVEC donations and sponsorship programs have been widely accepted and acclaimed by its members.[30] Furthermore, SSVEC asserts, as in the prior rate case, Mr. Blair testified why it is important for a rural cooperative to be able to continue to make charitable contributions; the February 11, 2009, public comment session demonstrated there is public support for the Cooperative's charitable programs; and Mr. Blair testified that charitable programs account for only about 3 percent of total revenues.[31]

SSVEC argues this is a very important issue as it underscores the difference between an investor-owned utility and a member-owned cooperative and the role of the cooperative in the rural community. SSVEC asserts that if its members were unwilling to support the Cooperative's ability to maintain these programs in favor of either lower rates or a return through capital credits, they would not have approved the by-law change by such an overwhelming margin. SSVEC states if members decide they do not want the Cooperative to continue such programs, they can initiate such a change through the Board. Furthermore, SSVEC states that if Staff's adjustment is adopted, the Cooperative will have to pay for these programs from its net income/ margins, which would be inconsistent with the goal of reaching a 30 percent equity level by 2016.

The Cooperative has shown that it complied with the directives of Decision No. 58358 by initiating the by-law change, filing the by-law change with the Commission Utilities Director; and submitting the by-law change to its members (where it was adopted by a 90 percent margin). SSVEC claims that its donations and sponsorships have been widely accepted and acclaimed by its members.[32] There is no indication that member/ratepayers are opposed to the Cooperative's charitable donations, and the record indicates there is support for the Cooperative's involvement in

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[29] Decision No. 58358 at 18 and 19.
[30] Ex A-18 Blair Rebuttal at 13-16; Rebuttal Exhibits JB-1 and JB-2, Tr at 341-48.
[31] *Id.* at 13; see also Transcript of February 11, 2009 Public Comment session.
[32] Ex A-18 at 13-17; Rebuttal Exhibits JB-1 and JB-2; Tr. at 341-48.

the community.[33] On the other hand, member/ratepayers are concerned about the impact of the rate increase and at least one member mentioned the role of charitable contributions as part of the need for increasing rates.[34]

The by-law change that was submitted to members in 1997 for approval states:

> ARTICLE IV – DIRECTORS. SECITON 4.07. Rules, Regulations, Rate Schedules and Contracts. The Board of Directors shall have power to make, adopt, amend, abolish and promulgate such rules, regulations, policies, rate schedules, contracts, security deposits and any other types of deposits, payments or charges, including contributions in aid of construction, advertising, and donations not inconsistent with law or the Cooperative's Articles of Incorporation or Bylaws, as it may deem advisable for the management, administration and regulation of the business and affairs of the Cooperative.

Mr. Blair testified that the by-law change added the power to make and adopt advertising and donations to the list of powers given to the Board of Directors.[35] Although the revised by-law provision gives the Cooperative's Board of Directors the power to make donations, it does not in and of itself, indicate that such donations will affect rates. We do not know what members were told in 1997 about how donations would be treated for ratemaking purposes as current management was not around at the time. The Cooperative has admitted that it has grown significantly in the past five years, and consequently, there are many more members now than in 1993, which makes it reasonable to re-examine the previous treatment of these expenditures. The previous rate Decision did not guarantee that charitable expenses would be allowed, even if the Cooperative complied with the directive to change the Bylaws. It is not clear whether current members are aware that the Cooperative's charitable donations and sponsorships can affect their rates. Although we recognize their importance to the community, we do not believe that charitable contributions and sponsorships are appropriate above-the-line expenses that should be collected from ratepayers. Consequently, we adopt Staff's recommendation to disallow these expenses. This is not to say that the Cooperative cannot, and should not, continue to make appropriate contributions at the discretion of the Board of Directors. As a member-owned cooperative we expect that the Cooperative will probably continue to make contributions, and we are mindful that to the extent the Directors elect to make such

[33] E.g. See Transcript of the February 11, 2009 Public Comment at 50-55.
[34] *Id.* at 47.
[35] Ex A-18. Blair Rebuttal at 15.

contributions it will affect the Cooperative's bottom line, and as such, in combination with other factors may affect how quickly the Cooperative is able to build equity. We do not believe, however, that maintaining the current level of contributions will substantially impair the Cooperative's ability to improve its equity. As optional expenses, the Board of Directors must balance various factors to determine the appropriate level of charitable contributions, just as they do with the return of capital credits.

Rate Case Expense

Staff and SSVEC disagree about the appropriate level of Rate Case Expense.

In its Application, SSVEC had included $100,000 of Rate Case Expense, that it proposed be recovered over five years, for a $20,000 annual Rate Case Expense. SSVEC states that the $100,000 represented the approximate amount of expenses that it had incurred at the time it filed the rate application. In her direct testimony, Rebecca Payne testified that: "actual rate case expense will only be known at the time of the hearing/settlement. Schedule RAP-2 shows invoices related to this case incurred up to the filing. We propose to provide invoices to ACC Staff for all additional rate case related expenses for a final determination of rate case expense."[36]

In rebuttal testimony, the Cooperative revised its total Rate Case Expense to $310,000 to reflect the legal and consulting fees that it had incurred as of February 27, 2009. SSVEC estimated it would incur an additional cost of $87,000 through the hearing. SSVEC requested a total Rate Case Expense of $397,608, recovered over a five-year period for an adjusted annual Rate Case Expense of $79,522. Thus, it was seeking an additional $59,522 in annual Rate Case Expense over the amount originally requested. In response to a data request, SSVEC provided Staff with invoices for the expenses that had been incurred.

In its direct case, Staff included, without comment, the $20,000 of annual Rate Case Expense as initially filed by the Cooperative. After receiving the Company's revised Rate Case Expense as set forth in Rebuttal Testimony, Staff did not modify its original position concerning Rate Case Expense, and recommends disallowing the additional $59,522 of annual Rate Case Expense.

[36] Ex A-15, Payne Direct at 7.

Staff believes that had SSVEC been more proactive in managing its Rate Case Expense it could have avoided quadrupling those costs. Staff asserts that SSVEC could have avoided the increase in the Rate Case Expense by (1) determining a rate case budget, (2) evaluating the strength of the issues in the case, and (3) assessing the marginal benefit of each cost. Staff states that SSVEC did none of these things to manage Rate Case Expense and recommends that all of SSVEC's Rate Case Expense above the original $100,000 estimate be disallowed as unreasonable.[37] Staff states that because SSVEC did not provide a detailed budget of Rate Case Expense, Staff was left with "no reasonable alternative but to recommend allowance of SSVEC's original estimate of rate case expense."[38] Staff believes the issue is one of prudency, and that in the absence of documentation to support the Cooperative's activities, "there is no way to make that determination."[39] Staff argues the legal expenses incurred by other utilities is not determinative of what was prudent in this case.[40] Staff states that its treatment of Rate Case Expense is consistent with SSVEC's last rate case[41]

SSVEC notes that the original $100,000 that the Cooperative proposed for total Rate Case Expense was not an estimate, as the testimony is clear that it was the amount of expense that was known at the time of filing, and that the Cooperative would be revising the number.[42] SSVEC also argues that Staff offered no evidence in support of its contention that SSVEC could have managed its rate case expense to avoid quadrupling the original estimate of $100,000. SSVEC asserts that many of the issues that arose in this case could not have been anticipated from the outset, including the large number of data requests (17 sets and 268 questions); the need to engage a power procurement witness to respond to Staff; a three-day hearing; the injection of the 69 kV line issue; the additional public comment session; and issues Staff initiated such as the recommendation to approve the WPFAC increases and the reset of the DSM adjustor.[43] SSVEC asserts that Staff fails to address the fact that Staff reviewed the invoices and had no problem with them, that the Commission has awarded other utilities more in rate case expense than is being requested here; that as a cooperative,

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[37] Ex S-7, Brown Surrebuttal at 9-10, Tr. at 361.
[38] Staff Opening Brief at 5.
[39] Staff Reply Brief at 4.
[40] *Id.* at 4.
[41] Staff Opening Brief at 5.
[42] Ex A-15, Payne Direct at 7.
[43] SSVEC Opening Brief at 25.

there are no shareholders to bear the uncovered amount of Rate Case Expense; that when it prepared its rate case, SSVEC had no way to know how many data requests would be issued or what additional issues would be included in the rate proceeding; that in order to mitigate the rate impact, the Cooperative is proposing to spread Rate Case Expense over five years instead of the more typical four years; that this rate case could not have been litigated for $100,000; that the Cooperative had to answer the data requests propounded by Staff whether it had a budget or not; and that any un-recovered Rate Case Expense would be paid from Operating Income which would have a negative impact on equity growth.

SSVEC presented a comparison of Rate Case Expense amounts that have been allowed in other rate case filings:[44]

| Utility | Decision No. | Date | Revenue Requirement | No. Customers | Approved Rate Case Expense | Amort period |
|---|---|---|---|---|---|---|
| UNS Electric | 70360 | 5/27/08 | $171,631,367 | 93,000 | $300,000 | 3 |
| Arizona American Water | 70351 | 5/16/08 | $9,711,596 | 23,000 | $94.264 | 4 |
| UNS Gas | 70011 | 11/27/07 | $178,393,000 | 140,000 | $300,000 | 3 |
| Far West Water &Sewer | 69335 | 2/20/07 | $1,900,786 | 5,500 | $160,000 | 3 |
| Black Mountain Sewer | 69164 | 12/5/06 | $1,375,037 | 1,957 | $150,000 | 4 |
| Arizona Water Company | 68302 | 11/14/05 | $12,140,321 | 20,266 | $250,000 | 3 |
| Chaparral City Water | 68176 | 9/30/05 | $7,795,935 | 12,000 | $285,000 | 4 |
| Pine Water Company | 67166 | 8/1-/04 | $922,984 | 2,000 | $200,000 | 4 |
| Arizona-American Water | 67093 | 6/30/04 | $10,331,873 | 15,000 | $418,941 | 3 |
| Arizona Water Company | 66849 | 3/19/04 | $18,909,627 | 29,000 | $250,000 | 3 |

We do not believe it is reasonable to hold a company strictly to its original estimate of Rate Case Expense regardless of intervening events. SSVEC provided invoices supporting all of its Rate Case Expense up to the hearing, and there is no indication that the expenses were unreasonable. This was a complex rate case because it was the first time either SSVEC was being reviewed as a PRM of AEPCO—a first not only for the Cooperative, but for Staff. In addition, the Cooperative had not

[44] SSVEC Opening Brief at Attachment A. By way of comparison, SSVEC requested revenue of $102,495,149, has 51,000 customers and requested Rate Case Expense of $397,606 amortized over 5 years.

prepared a rate case in 16 years. There was a large number of data requests, new issues of fuel procurement and the injection of the issue of the Sonoita Reliability Project. Some of the rate case expenses were incurred as a result of the need to respond to a unique circumstance or issues of first impression, that are not likely to arise in the future as both the Cooperative and Staff gain experience with SSVEC as a PRM. In this case, we find that a total Rate Case Expense of $300,000 is fair and reasonable, and represents a more realistic level of total Rate Case Expense. Spreading recovery of this over ten years results in an annual adjusted Rate Case Expense of $30,000, which we find is an appropriate level of Rate Case Expense. SSVEC was not definitive about when it expects to file its next rate case, but projects between three and eight years.[45] Given that it has been 16 years since SSVEC's last rate case, and given the surplus recovery of SSVEC's prior rate case expenses, we believe it is appropriate to amortize SSVEC's rate case expenses over ten years. The ten year recovery period we adopt is longer than usually seen for an investor-owned utility, but not unreasonable in light of the circumstances of this case.

Test Year Operating Income

With respect to Payroll Expenses, Year End Bonus and Safety Pay and Charitable Expenses, we adopt Staff's adjustments. As discussed herein, we adjust Staff's recommended recovery of Rate Case Expense. Based on the foregoing, we determine adjusted Test Year Revenues and Operating Expenses as follows:

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| Total Revenues | $92,825,281 |
| Total Expenses | $85,105,081 |
| Operating Income | $ 7,720,200 |
| Interest Expense & Other Deductions | $ 7,106,255 |
| Non-Operating Additions | $ 667,660 |
| Net Income | $ 1,281,605 |

Thus, in the Test Year, the Cooperative experienced a return on FVRB of 5.81 percent.

Revenue Requirement

SSVEC and Staff agree that the Cooperative's goal of increasing its equity to 30 percent of total capital by 2016 is reasonable. They disagree, however, on the level of revenue that would be

[45] Tr. at 84-85.

required to reach this goal.

Staff argues that its recommended revenue level will allow SSVEC to achieve the 30 percent equity goal. Staff assumes SSVEC will pay down its long-term debt by utilizing $3 million from its Net Income, and that SSVEC's future borrowing will be 10 percent lower than SSVEC has projected because the Cooperative's growth rates will slow due to economic conditions.[46] Staff asserts that SSVEC developed its revenue requirement in part to allow for higher capital credit retirements,[47] and made assumptions about long-term debt that are not reasonable, which led Staff to reduce those assumptions by 10 percent.[48] To the first point, Staff believes that given the current economic difficulties nationwide, "it is not an appropriate time to increase the amount of money taken from members, simply for the stated purpose of increasing the amount of money to be returned to them in the future."[49] Based on public comment, Staff does not believe there is member support to increase capital retirements.[50] Secondly, Staff asserts that SSVEC admitted that its debt projections represented the minimum amount of debt that it could incur, not that it would incur.[51] Moreover, Staff notes that its revenue requirement results in a DSC of 2.12, which exceeds the minimum requirement of SSVEC's lender, the Cooperative Finance Corporation ("CFC"), which only requires a DSC of 1.35.

SSVEC asserts there is no basis for Staff to lower projected long-term debt by $3 million. SSVEC claims that Staff could not explain why it was appropriate for SSVEC to utilize $3 million of its net income to reduce its long-term debt.[52] SSVEC states that under Staff's analysis, the Cooperative would be $3 million short each year in its efforts to build equity. In addition, SSVEC asserts there is no basis for Staff's assumption that SSVEC's debt will fall by 10 percent in 2012, as there is no evidence in the record to support the claim. Staff testified that because of the "bad economy" Staff does not believe that the Cooperative will grow at the same pace and will not need to

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[46] Staff Opening Brief at 6.
[47] The Cooperative's Board of Directors determines annually how much of its Net Income should be returned to its members in the form of retired capital credits.
[48] Tr. at 396-397.
[49] Staff Reply Brief at 2.
[50] *Id.* at 2.
[51] Tr. at 242.
[52] SSVEC Reply Brief at 4-5, citing Tr at 389-391 and 394.

borrow as much.[53] SSVEC argues Staff's 10 percent reduction in long-term debt levels in 2012 was an arbitrary determination made to justify lowering the revenue requirement.[54] The Cooperative notes that Mr. Huber testified that the Cooperative's level of capital projects would continue into the future which would necessitate its current level of borrowing.[55] SSVEC asserts that Staff offered no evidence about the Cooperative's level of growth or need for plant additions. Consequently, SSVEC argues Staff's assumptions are without foundation, and asserts that Mr. Huber is the person with the most direct knowledge about the capital needs of the Cooperative. SSVEC states further, that it was being conservative in its projections by using the minimum amount of debt that it will need.[56]

SSVEC asserts that Staff's adjustments to income were arbitrary and made solely to reduce the rate increase. SSVEC argues that speculation and arbitrary assumptions are not substantial evidence and cannot be determinative.[57] SSVEC argues that its requested revenue requirement was developed to allow it to reach 30 percent equity capitalization within a reasonable period, and that Staff's suggestion that it is seeking additional revenues to fund higher capital credit retirement is baseless. SSVEC notes that Mr. Huber testified that it would not be until after the Cooperative reached 30 percent equity that it would seek higher capital credit retirement.[58]

We find that Staff's revenue requirement, adjusted to reflect our determination of the recovery of Rate Case Expense, of $100,430,597 will allow the Cooperative to meet its lender's required financial ratios and achieve a 30 percent equity ratio in a reasonable period of time. This revenue level is an increase of $7,605,316 or 8.19 percent, over Test Year revenues.

## Rate Design

Customer Charge

SSVEC seeks to increase its monthly customer charge by $5.00, from $7.50 to $12.50 for residential customers, and seeks similar increases in the monthly customer charge for other customer classes. Staff recommends an increase in the monthly residential customer charge of $0.75 from

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[53] Tr. at 396-397.
[54] SSVEC Reply Brief at 6.
[55] Tr. at 85-87.
[56] SSVEC Reply Brief at 7.
[57] *City of Tucson v. Citizens Utilities Water Company*, 17 Ariz. App. 477, 481 P.2d 551, 555 (Ct. App. 1972).
[58] SSVEC Rely Brief at 7, citing Tr. at 233 and 249.

$7.50 to $8.25. With the exception of the amount of the customer charges, SSVEC has agreed to Staff's recommend time-of-use rates ("TOU").[59]

SSVEC presented a cost study that shows the cost of serving a residential customer is $23.31 per month. Staff accepts the Cooperative's cost study. SSVEC argues that its proposed increase in the customer charge is more reflective of the cost of providing service, and that to send a proper pricing signal, the fixed customer charge component of the rate should be increased closer to the actual cost. SSVEC states that while Staff's characterization of the customer charge as a 67 percent increase is technically correct for a customer with no kWh usage, it is misleading because it singles out only one component of the requested increase.[60]

SSVEC also notes that the Commission has previously approved increases in customer charges for other cooperatives which are similar to those SSVEC requests in this case. For example, SSVEC notes that in its last rate cases, Trico's residential customer charge was increased from $8.00 to $12.00 per month, and Navopache's residential customer charge was increased from $11.25 to $18.30 per month.

Staff notes that the Cooperative admits that an increase in the customer charge promotes the de-coupling of rates, thereby making SSVEC less dependent upon the sale of energy to recover its distribution costs.[61] Staff believes that its proposal, under which the Cooperative would recover 35 percent of the customer related costs, is a more reasonable step than the Cooperative's proposal which recovers 54 percent of customer related costs.[62] Staff believes it is unreasonable to expect customers to "absorb increases that average 63.08 % in one step."[63] Staff claims that a significant increase in the monthly customer charges makes it more difficult for customers to implement conservation measures to reduce the amount of the total monthly bill.

The following lists the current, Staff proposed and SSVEC proposed monthly customer charges:

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[59] SSVEC Opening Brief at 10.
[60] Ex A-9 Hedrick Rejoinder at 16.
[61] Ex A-8 Hedrick Rebuttal at 21.
[62] Staff Opening Brief at 15.
[63] *Id.* at 5-9; Ex S-9 Musgrove Surrebuttal at 3.

| | Current | Staff | SSVEC |
|---|---|---|---|
| Residential | $7.50 | $ 8.25 | $12.50 |
| Residential TOU | $11.40 | $13.25 | $13.25[64] |
| GS (Non-Demand) | $11.50 | $13.50 | $17.50 |
| GS Demand | $11.50 | $13.35 | $17.50 |
| GS TOU | $12.75 | $14.45 | $21.50 |
| Large Power | $42.00 | $44.25 | $75.00 |
| LP Seasonal | $50.00 | $56.25 | $75.00 |
| LP TOU | $43.84 | $44.45 | $100.00 |

We will adopt Staff's proposed monthly customer charges.

Service Related Charges

SSVEC's current service charges and the recommended charges are as follows: [65]

| | Existing | SSVEC proposed | Staff recommended |
|---|---|---|---|
| Return Check | $15.00 | $25.00 | $25.00 |
| **Existing Member Connect Fee-Regular Hours** | **25.00** | **50.00** | **40.00** |
| Connect Fee-After hours | 45.00 | 75.00 | 75.00 |
| New Connects | 0.00 | 50.00 | 50.00 |
| **Non-Pay Trip Fee – Regular Hours** | **25.00** | **50.00** | **40.00** |
| Non-Pay Trip Fee – After hours | 45.00 | 75.00 | 75.00 |
| Service Charge Regular Hours | 45.00 | 50.00 | 50.00 |
| Service Charge After hours | 45.00 | 75.00 | 75.00 |

Staff and SSVEC agree on all service fee charges except for Existing Member Connect-Regular Hours and Non-Pay Trip Fee- Regular Hours. SSVEC is proposing $50 for each of these charges, while Staff is recommending $40.

SSVEC argues that its proposed increase in service related charges moves the charges closer to the actual cost of providing the service, and helps to mitigate the need for the Cooperative to subsidize the costs of these services. The Cooperative's studies indicate the cost of the Member

[64] The Cooperative initially proposed a $16.50 customer charge for Residential TOU, but the Cooperative subsequently adopted the Staff's proposed TOU rates. Accordingly, we will approve Staff's proposed customer charge of $13.25 to prevent over-collection from the Residential TOU customers.

[65] Those in bold are the only disputed charges.

Connect Fee to be $94.78 and the Non-Pay Trip Fee to be $138.29.[66]

Staff asserts that the difference between what SSVEC is proposing and what Staff is recommending with respect to these two services would produce approximately $200,000 in additional revenues, which is more than a de minimus amount.[67] Staff could not incorporate the $50 fee for these charges in its rate design without producing a material amount of additional revenue over the amount of the total revenue increase being recommended. Furthermore, Staff argues its proposed increases for the disputed charges are supported by increases experienced in related labor costs over the 16 year period since SSVEC's last rate case.

SSVEC claims that Staff's recommended allocations have no bearing on whether the Cooperative's proposed service charges are just and reasonable.[68] SSVEC asserts that Staff's approach that considered the increase in the cost of labor since 1993 did not take into account whether the rate established in 1993 covered the Cooperative's actual cost of providing the service.[69] SSVEC argues that to the extent the Cooperative was not recovering its costs in 1993, it is not the appropriate starting point to set the rate in 2009. The Cooperative believes that the establishment of appropriate service charges is a clear way to achieve the Commission expressed goal -- that to the extent practical, the costs of providing the service should be borne by those who cause the costs to be incurred.[70]

We believe Staff's recommended service charges are reasonable.

**Residential TOU Participation**

The Commission is concerned by the lack of participation in the Cooperative's Residential TOU program, and believes this may signal that the Cooperative's Residential TOU program does not offer ratepayers a realistic opportunity to save money by shifting their usage to off-peak hours. We will require the Cooperative to submit an annual report to the Commission detailing the total number of Residential TOU ratepayers and the savings or losses experienced by the participants on the Residential TOU plan.

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[66] Ex A-8 Hedrick Rebuttal at 24; Schedule DH-21.
[67] Tr. at 477-478.
[68] SSVEC Reply Brief at 28.
[69] SSVEC Opening Brief at 51.
[70] Ex A-9, Hedrick Rejoinder at 17.

If, after two years from the effective date of this Decision, less than 10 percent of eligible ratepayers are participating in Residential TOU plan, we will require SSVEC to file a plan, for Commission approval, to increase participation in the Residential TOU plan to at least 10 percent. The plan may include, among other things, additional advertising of the Residential TOU plan or modifications to the on-peak/off-peak hours or rates of the Plan.

## Demand Side Management and Renewable Energy Standard Tariff

As part of this application, SSVEC submitted for Commission approval three new DSM programs and modification to one of its existing programs. The proposed new programs include: (1) an Energy Efficient Water Heater Rebate Program; (2) the Commercial and Industrial Energy Efficiency Improvement Loan Program ("C&ILP") and (3) the Energy Efficient New Home or Remodel Rebate Program. SSVEC proposed modifications to its existing loan program which is now being called the Energy Efficient Improvement Loan Program ("EEILP"). As previously noted, the parties agreed that in lieu of filing a separate application for approval of the new DSM programs, Staff would make its recommendations concerning the DSM programs in a late-filed exhibit to this proceeding.[71]

### DSM and Renewable Energy Standard Tariff Adjustor mechanisms

In its pre-hearing testimony, Staff enumerated sixteen recommendations relating to DSM and the Renewable Energy Standard Tariff ("REST").[72] Staff recommends as follows:

1. SSVEC file with Docket Control a revised version of the DSM program description that removes reference to Time-of-Use ("TOU") rates and controlled rate program for irrigators;
2. Costs prudently incurred in connection with Commission-approved DSM activities be recovered entirely through a DSM Adjustment Tariff;[73]
3. Commission-approved DSM costs should be assessed to all SSVEC electric customers as a clearly labeled single line item per kWh charge on customer bills;

[71] Staff addressed its recommendations concerning the DSM adjustor mechanism in its pre-hearing testimony and made recommendations concerning the new DSM programs and the 2007 and 2008 DSM program expenses in the Supplemental Testimony of Steve Irvine dated May 22, 2009.
[72] Ex S-10, Irvine Direct at 23-25.
[73] Heretofore, SSVEC recovers DSM program costs through its WPCA.

4. Should the Commission approve SSVEC's recommendation to include some part of DSM program expense in base rates, it should be clarified that a negative DSM adjuster may be used to lower DSM program expense recovery below the rate included in base rates;
5. SSVEC continue to report on DSM program expenses semi-annually;[74]
6. SSVEC file the DSM program expense reports in Docket Control and that SSVEC redact any personal customer information;
7. SSVEC's DSM program expense reports should include the following: (i) the number of measures installed/homes built/participation levels; (ii) copies of marketing materials; (iii) estimated cost savings to participants; (iv) gas and electric savings as determined by the monitoring and evaluation process; (v) estimated environmental savings; (vi) the total amount of the program budget spent during the previous six months and, in the end of year report, during the calendar year; (vii) the amount spent since the inception of the program; (viii) any significant impacts on program cost-effectiveness; (ix) descriptions of any problems and proposed solutions, including movements of funding from one program to another; (x) any major changes, including termination of the program. SSVEC should file its new proposed DSM adjustor rate with Docket Control by March 1st of each year, and that such filing be considered and adjudicated by the Commission in Open Meeting;[75]
8. SSVEC's DSM adjustor rate be reset annually on June 1st of each year and that the per kWh rate be based upon currently projected DSM costs for that year (the year for which the calculation is being made) adjusted by the previous year's over- or under-collection, divided by projected retail sales (kWh) for that same year;

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[74] The parties have agreed that the semi-annual reports should be filed by March 1st (for the period July through December) and by September 1st (for the period January through June).

[75] Staff originally recommended the DSM adjustor reset be filed by April 1st, but agreed with the Cooperative's request to have the DSM adjustor reset filing due at the same time as its adjustor report. See Staff Opening Brief at 8-9.

9. SSVEC's annually proposed new DSM adjustor rate become effective on June 1st after approval by the Commission;

10. SSVEC submit proposed programs to the Commission for approval;

11. SSVEC file an application requesting approval of the new DSM programs proposed by SSVEC as part of this rate application;[76]

12. The initial DSM adjustor rate be set to recover prudently incurred DSM costs associated only with approved programs presently in place;

13. Prudently incurred costs associated with approved DSM programs that have been factored into the WPCA/WPFCA account balance remain in the WPFCA account balance;

14. The adjustor rate be set at $0.00088 per kWh[77] until the annual reset of the adjustor rate;

15. The Commission authorize an adjustor mechanism for SSVEC to replace the REST Surcharge; and

16. SSVEC file with the Commission a REST tariff with conforming changes within 30 days of the date of the Decision in this case to reflect recovery through the adjustor rather than through the surcharge used currently.

SSVEC agrees to Staff's recommendations, <u>except</u> that SSVEC argues that the June 1st reset date (Recommendation No. 9) should be a "hard" deadline, such that the new DSM adjustor rate would go into effect automatically unless the Commission acts prior to June 1.

Staff argues that SSVEC's position for an automatic reset of the DSM adjustor is not appropriate. Staff asserts that having the DSM adjustor rate adjudicated by the Commission will allow the Commission to directly manage recovery of DSM costs and consider the impact on ratepayers. Staff believes that because changes to the DSM adjustor rate have a direct impact on customer bills, it is appropriate that the adjustor rate be reset by order of the Commission. Staff notes further that there is no need for an automatic reset of the DSM adjustor rate because SSVEC would

[76] As stated previously, Staff agreed to review and recommend SSVEC's new DSM programs as part of this proceeding.
[77] Originally Staff recommended $0.000256 per kWh, but revised the figure after Staff's recommendations for the new DSM programs.

be able to continue to recover its DSM program expenses through the existing rate. Staff states that uncollected expenses are recorded in the DSM adjustor account and can be recovered through future rates, and that in the long run SSVEC would see no loss for having waited to implement a new adjustor rate.

SSVEC is concerned that even by filing its proposed DSM adjustor rate by March 1 of each year, the Commission is unlikely to be in a position to approve the filing on or before June 1.[78] According to SSVEC, its proposal for an automatic adjustment absent Commission action would not deny the Commission the opportunity to consider and approve the matter; provides flexibility; gives the Commission 90 days to act; allows the Commission to 'true-up" the adjustor the following year; gives the Cooperative certainty by not having to wait to recover additional program expenses; and would give SSVEC more motivation to promote and expand DSM programs.[79] SSVEC asserts Staff's position does not consider that the process to reset the DSM adjustor can take as long as four or five months to approve, and that DSM program expenses that SSVEC incurred in the prior calendar year could not be recovered until the Commission acted. SSVEC is frustrated by the approval process because it is outside of the Cooperative's control, and in the past it has taken years to obtain approval to collect DSM program expenses.[80] SSVEC claims it is not in a financial position to "lay out" money for extended periods while it waits for Commission approval.[81]

In addition, SSVEC requests that there be language as part of this Order that would not preclude SSVEC from filing for a reset of its DSM adjustor more than once a year if the Cooperative deemed it necessary.[82] Staff does not oppose this request.[83]

We agree with Staff that the new DSM adjustor rate should not go into effect except by Commission Order. The DSM adjustor has a direct impact on customer bills, and to have the new

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[78] Ex A-18 at 6.
[79] SSVEC Reply Brief at 25.
[80] From the period 2001 through 2006, SSVEC submitted semi-annual DSM program expenses for Staff approval pursuant to the mechanism established in the last rate case. In that period, SSVEC submitted DSM program expenses totaling $549,929; Staff did not approve $502,414 of such expenses until July 8, 2009. See Tr at 564-566; and Ex. A-24 and A-25. SSVEC submitted its 2007 and 2008 DSM expenses for Staff approval on a semi-annual basis, such expenses were not approved until Staff filed the Supplemental Testimony of Mr. Irvine with its Opening Brief in this matter. See Tr. at 566-567; and also Late-filed Supplemental Testimony of Mr. Irvine.
[81] SSVEC Opening Brief at 49.
[82] *Id.* at 50.
[83] Tr. at 581-2.

rate go into effect automatically would diminish the Commission's ability to implement rates. Staff's recommendation on this issue is consistent with recent Commission policy and actions. Under such procedures, the Cooperative is protected in that uncollected expenses associated with approved DSM programs will be recovered in the DSM adjustor account and can be recovered through future rates.

We also believe that the Cooperative's request to be able to file for a change to its DSM adjustor more than once a year if the Cooperative has a valid need is reasonable. Such authority allows the Cooperative to react quickly to changing circumstances. However, the Cooperative should be judicious in deciding when to make extra filings, as too frequent requests to reset the DSM adjustor would increase costs and may cause customer confusion. Because the DSM adjustor is based on a projected budget, the Cooperative should only need to make an additional filing if it needs to implement a new program with substantial benefits, or additional funding is required for an existing program that has demonstrated substantial system or societal benefits.

SSVEC agrees with Staff Recommendation No. 10 that new DSM programs be submitted to the Commission for approval. SSVEC requests, however, that it be permitted to offer new DSM programs to its members prior to Commission approval and report the related expenses as part of its semi-annual reports. SSVEC acknowledges that if the new program is not subsequently approved by the Commission, it would not be permitted to recover the expenses associated with that program. If however, the new program is approved by the Commission, SSVEC would be able to recover the associated expenses through the DSM adjustor, and have them trued-up to the date it started offering the program. Staff agrees with SSVEC's position on new DSM programs.[84]

We concur with the parties' position concerning new DSM programs. This understanding will allow SSVEC to implement new, beneficial DSM programs in a timely fashion. Customer rates would not be affected, unless and until the Commission approves the program and then also approves a change to the DSM adjustor rate.

With respect to Recommendation No. 13, SSVEC agrees with Staff that DSM program expenses that have not yet been fully recovered through the WPCA/WPFCA would remain in the

[84] Staff Opening Brief at 10.

WPFC/WPFCA, and that 2007 and 2008 program expenses that were under review by Staff during this proceeding for approval pursuant to Decision No. 58358 would also be recovered through the WPFCA.[85] The parties agree that all 2009 approved DSM program expenses will be reported and be potentially recoverable through the DSM adjustor.[86]

New DSM Programs and 2007 and 2008 DSM expenses

SSVEC proposed DSM programs including an Energy Efficient Water Heater Rebate program, a Commercial and Industrial Energy Efficiency Improvement Loan program, and Energy Efficient New Home or Remodel Rebate program. Staff also reviewed and made recommendations concerning SSVEC's DSM Expense Reports for 2007 and 2008.

With respect to the above, Staff recommends:

1. Approval of the Energy Efficient Water Heater Rebate program with certain changes;
2. To be eligible for the rebate, the energy factor for the purchased water heaters must be greater than the federal standard for new manufacture;
3. The water heater rebate should be set at $100;
4. SSVEC operate the water heater program without providing incentives for tankless water heaters at this time;
5. The Commercial and Industrial Energy Efficiency Improvement Loan program be approved as a pilot-program for a period of 16 months, and that following the 12th month of program operation, SSVEC make a filing detailing its experience with the program and a recommendation regarding continuation of the program;
6. Loans made in the Industrial Energy Efficiency Improvement Loan program be interest free;
7. The Energy Efficient Improvement Loan Program be interest-free in order to make them more accessible to customers;
8. The proposed Energy Efficient New Home or Remodel Rebate program be denied;

[85] On May 22, 2009, Staff issued a letter to the Cooperative approving $416,383.11 of SSVEC's 2007 and 2008 DSM Program expenses, which expenses will be recovered through SSVEC's WPCA/WPFCA.
[86] Staff Opening Brief at 11.

9. SSVEC discontinue offering any incentive related to the replacement of any heating or cooling appliance using an energy source other than electricity with an electric appliance in order to promote fuel switching.

Additionally, Staff recommends a DSM budget for SSVEC as follows[87]:

| | |
|---|---|
| Residential Programs | |
| Residential Energy Management | $50,000 |
| Touchstone Energy Efficient Home Program | $175,000 |
| Energy Efficient Water Heater Rebates | $25,000 |
| Energy Efficient Heat Pump Rebate | $20,000 |
| Energy Efficient Improvement Loan Program | $200,000 |
| | |
| Commercial and Industrial Programs | |
| Commercial and Industrial Energy Management | $4,500 |
| C and I Energy Efficient Improvement Loan Program | $150,000 |
| Energy Efficient Water Heater Rebates | See Above |
| Energy Efficient Heat Pump Rebate | See Above |
| | |
| Advertising Program | |
| Advertising brochures | $ 80,000 |
| Total Annual DSM Budget | $704,500 |

Based on the foregoing, Staff recommends the new DSM adjustor rate should be $0.00088 per kWh.[88] The DSM adjustor is calculated by dividing the budget of the approved projects by the

[87] Staff Reply Brief at 6, Attachment 1.

[88] SSVEC agreed with the recommendations in Mr. Irvine's Supplemental Testimony, except it had two concerns with Staff's recommendation that the EEILP interest rate be lowered from 3 percent to 0 percent to make it more accessible to customers. First, SSVEC was concerned that Staff's recommendation would result in increased costs to the Cooperative that were not reflected in Staff's recommended DSM adjustor rate of $0.000474 per kWh. Second, based on focus group information, by lowering the interest rate, the Cooperative expects more customers will participate in the program, and it would incur additional expenses more quickly. Consequently, SSVEC discussed the matter with Staff and requested that to cover the costs of the C&ILP and EEILP, the adjustor rate be increased to $0.00088 per kWh. With this agreement to the DSM adjustor rate, the Cooperative states it agrees with all of Staff's recommendations set forth in the Supplemental Testimony. Staff agrees with the $0.00088 per kWh. See Staff Reply Brief Attachment 1.

projected kWh retail sales ($704,500/799,860,156 kWh's=$0.000881 per kWh). Staff calculates that for a residential customer on the Residential Service – Schedule R tariff with average monthly usage of 728 kWh, the initial DSM adjustor rate ($0.00088 per kWh) would result in a monthly charge of $0.64, or $7.69 per year. According to Staff, a commercial customer on the General Service – Schedule GS tariff, using the monthly average of 483 kWh, would pay a monthly charge of $0.43, or $5.10 annually.[89]

Staff's recommendations concerning SSVEC's DSM programs and the initial DSM adjustor are reasonable and we adopt them.

**Wholesale Power and Fuel Cost Adjustor ("WPFCA")**

The Wholesale Power and Fuel Cost Adjustor is a purchased power adjustor that uses charges or credits to allow the Cooperative to collect or refund the difference between the base cost and the actual cost of wholesale power. Currently, SSVEC has the authority to change the fuel adjustor rate without Commission approval. In this case, SSVEC proposed that it be allowed to adjust the WPFCA rate without Commission approval unless such adjustment would result in a cumulative annual increase in the total average rate collected from customers per kWh greater than 10 percent.[90] SSVEC further requests that any increase submitted to the Commission for approval in excess of the 10 percent limit would become effective in 60 days unless the Commission took action.[91] SSVEC claims that its proposal would allow it to recover routine fluctuations in fuel costs in a timely manner, but the 10 percent limit would ensure that a significant increase would not be implemented unless approved by the Commission. The Cooperative also requests that the WPFCA include fuel costs that would arise from its own generating units.

Staff recommends that SSVEC be required to submit proposed increases to the WPFCA rate to the Commission for approval, but not be required to seek approval for decreases to its WPFCA rate.[92] In addition, Staff recommends establishing thresholds that would trigger changes in the WPFCA for both under- and over- collected bank balances.[93] Staff recommends a $2 million

[89] Staff Reply Brief, Attachment 1.
[90] Ex A-8 Hedrick Rebuttal at 19.
[91] *Id.*
[92] Ex S-12 McNeely-Kirwin Direct at 7-8.
[93] *Id.*

threshold for under-collection and a $1 million threshold for over-collection. Under Staff's recommendation, SSVEC would be required to file an application to increase the WPFCA rate either when the bank balance reaches the $2 million threshold for under-collected balances for two consecutive months, or when it reasonably anticipates that the threshold will be reached within six months and would continue at or above the threshold for two or more consecutive months. Staff asserts that the threshold would limit the size of any negative bank balance that could accumulate, limit increases to the WPFCA, and limit rate shocks to customers. Under Staff's proposal, SSVEC could return over-collected bank balances to its customers at anytime, except that it must return over-collected amounts once the over-collected bank balance reaches $1 million and remains over that threshold amount for two consecutive months. Staff states that this mechanism would ensure that positive bank balances are returned to customers in a timely and predictable fashion.[94] Staff does not appose the collection of fuel costs associated with future Cooperative owned generation plants.[95] Staff recommends certain fuel expenses that should be included in the WPFCA. [96]

SSVEC agrees with Staff's recommended threshold amounts.[97] SSVEC argues, however, that it should not have to seek Commission approval every time it determines it must increase the WPFCA. SSVEC does not believe that Staff's position takes into account that despite being a PRM, the Cooperative will obtain approximately 80 percent of its power needs from AEPCO, and that through 2012 it could obtain as much as between 75.3 and 88.3 percent of its power from AEPCO. SSVEC claims it cannot control the fuel costs that AEPCO passes through to its members in AEPCO's Commission-approved adjustor. SSVEC asserts that Staff's position will result in the Commission reviewing power costs twice because the majority of such costs will have been reviewed for AEPCO prior to the pass through to SSVEC.

SSVEC claims that having to file for any and all increases to its WPFCA would: (i) negatively impact its ability to administer its bank balance; (ii) require the Cooperative to use its net income to "lay out" the money to purchase the power for extended periods of time; (iii) require the

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[94] *Id.* at 9.
[95] Ex S-12 McNeely Kirwin Direct at 11.
[96] *Id.* At 11-12.
[97] SSVEC Reply Brief at 17.

expenditure of time, money and resources for a Commission proceeding to implement even a small increase; (iv) cause significant delay in its ability to recover costs; and (v) hinder its ability to comply with the under-collection bank balance threshold. SSVEC asserts the agreed-upon thresholds for under- and over-collections will address Staff's concerns about rate shock. SSVEC believes that Staff's position is an over-reaction to an anomalous situation in 2008 when fuel prices were especially volatile during SSVEC's first year of operations as a PRM.

SSVEC argues further that if the Commission requires SSVEC to file for increases in the WPFCA, the agreed-upon WPFCA rate should be considered an initial ceiling for adjustment purposes. Under this proposal, if the WPFAC rate is lowered such that it is below the initial rate, then SSVEC would not need to seek Commission approval to raise the rate back to the original level.[98] Staff opposes this proposal.[99]

Alternatively, SSVEC proposes that if the Commission requires the Cooperative to file for an increase in its WPFCA, the increase should go into effect if the Commission does not act upon the filing within 60 days.[100] SSVEC notes that Staff admits that it can take as long as four or five months for the Commission to approve an adjuster reset.[101] Moreover, SSVEC claims, the Commission has approved adjustors for AEPCO,[102] Arizona Public Service[103] and UNS Electric[104] that go into effect unless suspended by the Commission. SSVEC requests to be treated in the same manner in the event the Commission requires it to seek approval of all WPFCA increases. In addition, SSVEC requests that if the Commission requires it to seek approval for all WPFCA increases, that power purchased from AEPCO that is passed through the Commission-approved AEPCO adjustor should not be considered for purposes of an increase to the WPFCA.[105]

On May 22, 2009, Staff issued a letter to the Cooperative approving $416,383.11 of SSVEC's 2007 and 2008 DSM Program expenses, which expenses will be recovered through SSVEC's

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98 SSVEC Opening Brief at 36.
99 Tr. at 610-11.
100 SSVEC Opening Brief at 57-8.
101 Tr. at 539.
102 Decision No. 68071 (August 17, 2005).
103 Decision No. 69639 (June 11, 2007).
104 Decision No. 70360 (May 27, 2008).
105 SSVEC Opening Brief at 39.

WPFCA. SSVEC requests that these costs associated with 2007 and 2008 DSM programs should be excluded for purposes of increases in the WPFCA and the $2 million under-recovery threshold. Staff opposes such treatment.[106] SSVEC argues Staff's position makes no practical sense because the DSM costs at issue were already expended and once recovered will be gone. SSVEC states that an additional "$416,383.11" in the adjustor bank balance will not cause rate shock and its inclusion is a temporary clean-up from the 1993 Rate Decision.

Staff argues that requiring Commission approval of any increase in the WPFCA rate would allow the Commission to ensure that SSVEC is requesting an appropriate WPFCA rate and that supporting projections are reasonable. Staff argues further that requiring Commission approval allows the Commission to assist in designing cost recovery to limit rate shocks by instituting graduated increases and limiting increases during the peak-usage months.[107] Staff believes that SSVEC's recent conversion from an ARM to a PRM has caused its energy costs to be more volatile, which has impacted the WPFCA rate. Staff argues that the Commission's rate making authority and obligation to set fair, just and reasonable rates includes the ways in which purchased power or fuel costs are passed on the customers.

Staff opposes the Cooperative's proposal for automatic adjustment because there is no way to determine what the impact would be on customer bills, and because Staff believes the proposal is unduly complex and difficult to track for compliance reasons. Furthermore, Staff asserts that the complexity of the proposal makes it unlikely to be transparent to ratepayers.[108] Staff states that the testimony at the hearing illustrates the complexity and ambiguity in SSVEC's proposal, as it is not clear whether SSVEC's proposal is premised on a 10 percent change in fuel costs, as suggested in written testimony, or whether it is based on a 10 percent change in the total customer bills, as it appears in verbal testimony.[109]

Staff asserts that SSVEC's argument that requiring Commission approval of the WPFCA will result in double review of the AEPCO portion of the fuel costs is not persuasive. Staff claims that if

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[106] Tr. at 608-09.
[107] Ex S-13 McNeely-Kirwin Surrebuttal at 2.
[108] Tr. at 598.
[109] Tr. at 256-57 and 663.

the AEPCO portion of the WPFCA has already been reviewed by Staff and approved, Staff would take notice of that fact in reviewing that component of the SSVEC WPFCA rather than "re-invent the wheel."[110]

Staff asserts that SSVEC's request that in the event the Commission orders that it file for an increase to its WPCA, that the increase should go into effect automatically if the Commission does not act on the request within 60 days, is also inappropriate because it would prevent the Commission from evaluating and considering the circumstances leading to the request.[111] Staff states that SSVEC has failed to demonstrate why a 60-day turnaround time is necessary or why the longer turnaround time is more than an inconvenience rather than a hardship.[112]

We agree with Staff's recommendation that SSVEC must apply for approval of any increase to its WPFAC rate. We do not find it in the public interest to allow increases in the WPFAC rate without Commission approval at this time. Neither are we convinced that the rate should be allowed to increase if the Commission does not act within 60 days. The Commission has limited resources and cannot determine in advance the demands that will be placed on those resources. The potential impact on rates is significant and it is not in the public interest for the Commission to abdicate its authority over rates. We believe that if it is true that the primary component of the WPFCA will be attributable to fuel costs passed through by AEPCO in its adjustor, Staff's review of any SSVEC application will be made all the easier and SSVEC should not experience long delays. We do not find the Cooperative's proposed limits on the automatic adjustment to be easily understood or tracked and believe that would create confusion for compliance and among ratepayers.

We concur with the parties that the WPFCA may include fuel costs associated with future Cooperative owned generation units, but make no conclusions at this juncture about the prudency of these potential future costs. We also adopt Staff's recommendations as set forth in the direct testimony of Ms. McNeely-Kirwin concerning the costs that are appropriately included in the WPFAC.

We agree with the Cooperative that the $416,383.11 of DSM costs for 2007 and 2008 that are

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[110] Staff Reply Brief at 6.
[111] *Id.*
[112] *Id.*

being collected as part of the WPFAC should not be included in the under-collected balance for purposes of determining if SSVEC has reached the $2 million threshold for filing a request to increase the WPFAC. These DSM costs are a finite sum and have already been incurred. Once collected they will not re-accrue. There is no reason for ratepayers to pay increased rates on account of these 2007 and 2008 DSM expenditures.

**Power Procurement**

By changing from an All Requirements Member ("ARM") to a PRM, SSVEC is responsible for procuring wholesale power needed to supplement the power that it obtains from AEPCO. SSVEC has estimated that it will receive approximately 80 percent of its power from AEPCO and 20 percent from other sources.[113]

Staff believes that since becoming a PRM, SSVEC has substantially increased its responsibility for ensuring reliable and economic service to its customers, including planning for power supplies, power purchases, identifying and evaluating power supply alternatives, selecting its preferred power suppliers, and implementing management's decisions. Staff notes that although SSVEC states it expects to obtain only 20 percent of its power needs from sources other than AEPCO, it is only required to purchase approximately 47 percent of its wholesale power from AEPCO.[114] Thus, Staff believes SSVEC's power procurement policies and performance could have a substantial effect on its costs. Staff agrees with SSVEC that 2008 was an anomalous year, not just because power prices were unusually volatile, but because SSVEC was developing more expertise operating as a PRM.

Because of SSVEC's new PRM status, Staff recommends that SSVEC develop more formal written procurement policies and procedures. Staff did not recommend that SSVEC adopt specific procedures concerning power procurement, but rather Staff developed criteria that it believes SSVEC should consider when developing written procurement policies. Staff believes the policies and procedures will provide guidance to, and a benchmark for, measuring the performance of those responsible for procuring power. Staff believes that top-level management should adopt the

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[113] Ex A-5 Brian Rebuttal at 3.
[114] Tr. at 172-73.

procedures to ensure the policies are given high priority. Staff states further that SSVEC needs to create a mechanism that allows it to systematically evaluate progress and results, by allowing SSVEC to compare its chosen procurement options with available alternatives.[115] In addition, Staff recommends the written procedures include a provision that allows SSVEC to update them, in order to have flexibility when conditions warrant.[116]

In addition, Staff recommends a prudence review of SSVEC's purchased power procurement process in the next rate case or three years, whichever is first. Staff explains the timing is designed to give SSVEC time to fully develop and implement its written purchase procurement policies.[117]

SSVEC argues there is a difference between a for-profit and a non-profit entity with regard to power purchases. SSVEC states that SSVEC's management and Board of Directors are evaluated, in part, based on their decisions with regard to power purchasing, and if its costs are too high, the cooperative's membership can overturn the Board, or the Board could change management. SSVEC argues that unlike an investor-owned utility, with a cooperative, it is the owner/members who are paying the fuel costs, while with an investor-owned utility, the owners do not pay the costs of power. According to SSVEC, the conflict between outside owners and ratepayers in the investor-owned model is the fundamental basis for regulation and for prudence reviews. SSVEC argues the natural incentive to keep rates low in a cooperative makes the prudence review unnecessary. SSVEC asserts that the Commission already monitors SSVEC's cost of power when SSVEC files monthly reports, and has the ability to review and evaluate SSVEC's power procurement activities, and can at any time request more information from SSVEC to further evaluate SSVEC's activities.

Furthermore, SSVEC notes that as a cooperative, any costs found to be imprudent as part of a prudence review cannot be charged to anyone other than the member ratepayers, as there are no shareholders to bear the brunt of such costs. SSVEC argues that it always endeavors to avoid imprudent costs, and the existence of a requirement to undergo a future prudence review will not alter its activities to procure power at the lowest possible cost. SSVEC believes that imposing the requirement of a prudency review would cause SSVEC to devote additional and significant time,

[115] Tr. at 119.
[116] *Id.*
[117] Ex S-3 Mendl Surrebuttal at 2.

limited resources, and expense, and is an over-reaction to the unique circumstances that arose in 2008.

Staff, however, believes that SSVEC takes a too narrow view of the function and value of a prudence review. Staff does not believe that SSVEC's status as a nonprofit is relevant, because the effect of higher than necessary fuel costs on customers is the same despite its non-profit cooperative structure. Staff states that a prudence review would simply improve the power procurement process to make it more transparent.[118]

Staff does not believe the monthly filings or the best practices obligations for fuel purchases provide the same safeguards as a prudence review. Staff states it has found that in some instances the monthly filings are inaccurate and need to be corrected. Staff does not believe that they create a complete picture that a prudence review would provide. According to Staff, the best practices for fuel procurement only apply to longer term contracts, while a prudence review would focus on the internal processes to determine how much to bid, when to bid, and the specific types of products being sought.

A prudence review does more than determine how fuel procurement costs should be allocated between owners and ratepayers. It can help determine the effectiveness of SSVEC's procurement policies and how well its management is able to operate under these policies. The information about management's effectiveness, or the tools to evaluate management with respect to fuel procurement may not be readily available to cooperative members, and consequently, members may not be able to make well-informed decisions concerning management's effectiveness in this area. On the other hand, if a review indicates that fuel procurement has not been prudent, there are no shareholders to be charged with the imprudently incurred costs. We do not have to decide now whether a fuel procurement prudency review should be required in three years or in the next rate case. We believe it is better to allow Staff to determine in the next rate case, based on intervening facts, how best to investigate SSVEC's fuel procurement policies and practices. This may result in a full prudency review, or it may involve a lesser investigation. Now that SSVEC is a PRM, such review is

[118] Tr. at 123.

appropriate and could either validate management's performance or result in recommendations to improve the process. By not mandating a full-blown prudency review now, we avoid committing Commission and Cooperative resources to a potentially expensive undertaking even if in the future, SSVEC ends up taking the vast majority of its power from AEPCO, or it is otherwise apparent that a prudency review is not necessary or unlikely to be helpful. SSVEC will be filing for changes to its WPFCA as well as other reports, and Staff will be able to monitor how the Cooperative's fuel purchases are affecting rates and can request additional information from SSVEC or conduct a prudency review sooner than the next rate case if it appears that SSVEC is not acting prudently with respect to fuel purchases. SSVEC has agreed to file written procurement policies as Staff recommended.

**Tariff Changes and Service Conditions and Miscellaneous**

The parties have agreed to SSVEC's proposed Service Conditions proposed in the Application as modified by Staff, and as set forth in Exhibit A-16 in this proceeding. These changes include the elimination of the construction allowance for line extensions. There was no opposition expressed in the proceeding to the elimination of the construction credit for line extensions. We note that the elimination of the credit is consistent with actions taken in connection with other utilities and with the concept that current ratepayers should not have to subsidize growth.

Additionally, SSVEC should submit for Commission approval revised line extension policies which reflect:

- A Schedule of Charges
- A statement that quotes provided to customers will be itemized
- Procedures for refunding amounts to customers when additional customers connect to the line extension.

With the exception of customer charges and the two service related fees, as discussed herein, SSVEC has agreed to Staff's revenue allocation and rate design, including Staff's recommended time-of use rates.[119]

[119] SSVEC Opening Brief at 10.

Staff has accepted SSVEC's proposed tariff changes, and SSVEC has agreed that in a future rate case filing, it will develop more detailed and conventional unbundled rates, which will not result in any incentive or disincentive for customers who want to choose competitive generation supplies.[120]

SSVEC has agreed with Staff's recommendation that within 30 days of a Decision in this matter, SSVEC will file with the Commission a tariff describing its bill estimation methodologies.[121]

## Sonoita Reliability Project

The Sonoita area is currently served by a 360-mile three-phase feeder line. SSVEC presented evidence that the Sonoita area is plagued by more outages than other areas in its service territory.[122] SSVEC states that it has been working hard toward a solution to bring quality, reliable power to the Sonoita/Elgin/Patagonia communities. After years of study and analysis, the Cooperative states that it identified that the best solution to the problem is a new substation in Sonoita, with four shorter feeders and upgrading the transmission to 69 kV (the "Project"). SSVEC claims that it considered community input in its decision and that its proposed route balances basic aspects of business practices and cost analysis. SSVEC determined that the final route should follow the existing easement along the San Ignacio Del Babocamri Land Grant ("SIDB"). According to SSVEC, the SIDB easement and affiliated easements to the original substation property have been on record for over 25 years.[123]

The evidence presented in the hearing indicates that the Sonoita area has had a 10-year average of 270 hours of outages per year because of the unreliability of the existing line. Mr. Huber testified for the Cooperative that he believed the community would continue to be plagued by outages if SSVEC does not move forward soon with the Project. He expressed concerns for the elderly and for businesses in the area. Mr. Huber testified that investing in renewable energy in the local area will not solve the problem as the problem is one of capacity and reliability. He also testified that the 69 kV line is not the reason the Cooperative filed the rate case.[124]

SSVEC believes that the option it chose for the 69 kV line is the only viable option, and it

[120] Ex S-8 Musgrove Direct at Executive Summary, ¶ 2; Ex A-8, Hedrick Rebuttal at 1-2.
[121] Ex S-8 Musgrove Direct at 12-13; Ex A-8 at 1-2.
[122] Tr. at 70, Ex A-4.
[123] *Id.*
[124] Tr. at 70-71; 90 – 108; Ex A-4.

claims that it will do everything that it can to mitigate the impacts. SSVEC notes that the Commission does not have jurisdiction over the siting of this line pursuant to A.R.S. §40-360, et seq.[125] SSVEC claims that further delay in the Project will increase its cost and prolong the risk of outages in the area. SSVEC believes that further delay could lead to the imposition of a moratorium on new hookups in the area as the existing line is at capacity.

Staff reviewed the Project. SSVEC notes that Staff testified that (1) SSVEC has evaluated numerous options for the Project and the Project will improve reliability in the affected area; (ii) SSVEC has communicated with its members in the area in an attempt to clarify that the primary issue related to the Project is reliability and the quality of service; and (iii) SSVEC should continue to upgrade its 69 kV sub-transmission and distribution system to improve system performance and reliability.[126]

Members from the Sonoita/Elgin/Patagonia area want the Cooperative to consider whether renewable distributed generation located in the area would eliminate the need for the new line. Some of the commenters in opposition to the line do not believe that the Cooperative has studied all reasonable alternatives.[127] They complain the Cooperative did not provide them with sufficient detail of the cost estimates to allow evaluation of the Cooperative's claims about the project. They dispute Cooperative claims that the existing line is at capacity. Some suggest the Cooperative should work with the community to reduce consumption especially during peak load, or that the Cooperative should double circuit the existing line. They question the Cooperative's projections on growth and future demand, claiming they are inflated, and that official growth projections predict growth less than 2.3 percent per year (282 people) for the next five years, and they argue that the addition of a 1 MW renewable energy plant every five years would cover increasing demand.[128]

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[125] SSVEC Opening Brief at 54.
[126] Ex S-5 Bahl Direct at 7; 19 and 20.
[127] *E.g.* see comments of Jeanne Horseman, filed May 6, 2009. See also comments of Gail Gertzwiller docketed December 8, and December 31, 2008. On January 15, 2009 a Petition seeking an alternative route for the 69 kV line signed by 60 individuals was docketed. The Commission received at least 20 written comments concerning the Sonoita Reliability Project, and six comments opposing the rate increase and one in favor of the increase. Over 30 additional individuals appeared at the February 11, 2009 Public Comment meeting in Sierra Vista, many to speak about the Sonoita Line, but others speaking about SSVEC's importance to the community or about the effect of higher rates. For additional Public Comment, see also Transcript of the April 21, 2009 hearing at 7-42.
[128] Horseman Comments at 4.

The Cooperative estimates that the Sonoita Reliability Project will cost $13.5 million, and that the cost will increase over time.[129] The current estimate is higher than the cost originally provided to members because the project has been modified to require a slightly longer line and because costs have increased with the passage of time.[130] Members in the local community have argued that having additional distributed generation in the local area would alleviate the need for the line upgrade. The Cooperative asserts, however, that the problem is one of capacity, and even with additional local generation, the line would need to be upgraded in order for the power to reach users.[131] The Cooperative asserts that because the existing line is at capacity, and at times exceeds capacity, the area is subject to blinking during periods of high demand.[132] The Cooperative claims that it receives numerous complaints from residents and businesses in the area about the blackouts, and suggests that these interests have been patient for a long time while the Cooperative works on a solution.[133] SSVEC states that breaking the line into smaller feeders will help reliability because a problem on one portion of the line will not affect the entire area. [134]

The evidence indicates that the planned upgrade of the existing 360 mile three phase feeder to a 69 kV line, with a new substation and four smaller feeders, will address the capacity issues and improve system reliability in the Sonoita area. The upgrade will not prevent local efforts to install renewable generation sources, but would enable the generation to be utilized by providing a transmission path.

The Commission's Line Siting Committee does not have jurisdiction over the siting of the proposed 69 kV line,[135] and the Commission does not design utility infrastructure. However, the Commission does have authority to ensure that the Cooperative is providing safe and reliable service. The Cooperative is responsible for designing and operating a safe and reliable system for all of its members. The Cooperative submitted evidence that the line is currently at capacity.

To allow substandard service is not in the public interest. SSVEC's management believes that

[129] Tr. at 101-03.
[130] Tr. at 103.
[131] Tr. at 98.
[132] Tr. at 92-93.
[133] Tr. at 302-303.
[134] Tr. at 93.
[135] A.R.S. §40-360 et al.

the *Sonoita Reliability Project* is required for it to provide safe and reliable service to the Sonoita area. Ultimately, the Cooperative is responsible for the quality of service for all of its members, and must make informed decisions on how to meet its obligation. The information presented in the course of this proceeding supports the Cooperative's position. The Cooperative has explored alternative configurations for the project and has selected the project as presented as the best balance between cost and impact on the community. Staff testified that the Project would improve reliability in the area.

However, we are concerned that once constructed, the project will permanently change the landscape for the impacted communities and the manner in which electric service is provided to the Cooperative's customers. We need to ensure that the goals of some in the local communities who want more investment in renewable generation to mitigate the need for the project have been fully considered by the Cooperative. We believe a feasibility study prepared on behalf of the Cooperative by an independent third party is necessary for further analysis and consideration of the issues presented, prior to proceeding with construction of the project. Therefore, we shall require the Cooperative to docket a feasibility study on the project and possible alternatives and hold public forums in the impacted communities. The public forums shall include an opportunity for community members' discussion on the feasibility study, including alternatives prior to construction of the project. At the conclusion of the public forums the Cooperative shall docket a report and minutes from the public forums.

We will require the Cooperative to file a report setting out a proposed plan for the public forums including the manner it intends to provide notice and the dates and times as well as topics to be addressed at the public forums. The topics shall include, but not be limited to, addressing how renewable energy generation (in particular distributed generation) could be incorporated into the generation plans to serve the area covered by the planned 69kV line and associated upgrades. We will also require SSVEC to file, by July 31, 2010, a report discussing the outcome of this public process and also discussing how the Cooperative plans to incorporate the reasonable and effective renewable energy proposals resulting from the public forums.

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Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

## FINDINGS OF FACT

1. On June 30, 2008, SSVEC filed with the Commission an application for a rate increase.

2. On July 18, 2008, SSVEC filed Revisions to its Application.

3. On July 30, 2008, Staff notified the Cooperative that its application was sufficient under the requirements outlined in A.A.C. R14-2-103, and classified the Cooperative as a Class A utility.

4. By Procedural Order dated August 18, 2008, a procedural schedule was established and the matter was set for hearing to commence on April 21, 2009.

5. On November 12, 2008, SSVEC filed a Notice of Filing Affidavits of Mailing and Publication, indicating that Public Notice of the Hearing was mailed to its members/customers between September 26, 2008, and October 24, 2008, and was published in the *Sierra Vista Herald/Bisbee Daily Review* on October 16, 2008, and in the *Weekly Bulletin*, the *San Pedro Valley News-Sun*, and the *Arizona Range News* on October 15, 2008.

6. On January 6, 2009, Staff filed a Request for Extension of Time to File the Direct Testimony of Jerry Mendl concerning purchased power procurement. SSVEC did not object, and the schedule for filing testimony was revised by Procedural Order dated January 6, 2009.

7. In response to comments received from customers, the Commission determined that there was sufficient interest in the rate case and the potentially related matter of a new 69 kV transmission line in the Sonoita area that a Public Comment meeting in the local community was warranted. By Procedural Order dated February 5, 2009, the Commission scheduled a Public Comment meeting to be held in Sierra Vista, Arizona on February 11, 2009.

8. On February 10, 2009, SSVEC filed Notice of Compliance with Publication and Notice of the February 11, 2009, Public Comment Meeting. SSVEC made arrangements for the *Sierra Vista Herald/Bisbee Daily Review,* the *Weekly Bulletin*, the *San Pedro Valley News-Sun*, and

the *Arizona Range News* to publish Notice of the Public Comment prior to February 11, 2009, and posted the Notice in the Community Events section of its website as well as in all SSVEC offices and operations facilities open to the public, and delivered copies to the Willcox library, post office and City Hall. Additionally, SSVEC stated an article discussing the Public Comment meeting appeared in the February 6, 2009, *Sierra Vista Herald*.

9. On February 11, 2009, the Commission held a Public Comment meeting in Sierra Vista.

10. On March 12, 2009, Staff filed a Motion for Extension of Time to File Surrebuttal Testimony of William Musgrove concerning rate design.

11. On March 18, 2009, SSVEC filed a Response to Staff's Motion. SSVEC did not oppose the request but sought assurances that other witnesses' testimony would be filed as scheduled and Staff would attempt to provide an electronic version of Mr. Musgrove's testimony when ready.

12. By Procedural Order dated March 19, 2009, Staff's Motion was granted.

13. The hearing convened as scheduled before a duly authorized Administrative Law Judge on April 21, 2009, at the Commission's offices in Tucson, Arizona, and continued through April 23, 2009. Creden Huber, David Hedrick, David Brian and John Blair testified for SSVEC. Jerry Mendl, William Musgrove, Crystal Brown, Julie McNeely-Kirwn and Steve Irvine testified for Staff. The parties stipulated to the admission of the pre-filed testimony of Rebecca Payne for the Cooperative and Prem Bahl for Staff.

14. SSVEC and Staff filed Opening Briefs on May 22, 2009, and Reply Briefs on June 9, 2009. Attached to Staff's Opening Brief was the Supplemental Testimony of Steve Irvine concerning Staff's review and recommendations on SSVEC's proposed new DSM programs.

15. On April 23, 2009, Commissioner Stump filed a letter in the docket requesting information from the Cooperative about the impact of the elimination of the credit of $1,740 for residential line extensions.

16. On April 24, 2009, Commissioner Newman filed a letter in the docket requested additional information about the Line Extension Policy.

17. On May 13, 2009, SSVEC filed Responses to Commissioner Stump and

Commissioner Newman.

18. On June 16, 2009, Staff filed Responses to Commissioner Stump and Commissioner Newman.

19. SSVEC is an Arizona member-owned non-profit rural electric distribution cooperative headquartered in Willcox, Arizona. The Cooperative is a Class A public service corporation that provides electric distribution service to approximately 51,000 members/customers located in most of Cochise County and portions of Santa Cruz, Pima and Graham Counties.

20. SSVEC is a Class A member of AEPCO, a generation cooperative.

21. On January 1, 2008, SSVEC converted its membership in AEPCO from an All Requirements Member to a Partial Requirements Member pursuant to Commission Decision No. 70105 (December 21, 2007).

22. The Cooperative's current rates were established in Decision No. 58358 (July 23, 1993).

23. As discussed herein, SSVEC's FVRB is determined to be $132,866,202, which is the same as its OCRB.

24. In the Test Year ended December 31, 2007, SSVEC had adjusted total revenues of $92,825,281.

25. As discussed herein, we find that in the Test Year, SSVEC's allowable Operating Expenses total $85,105,081, resulting in Operating Income of $7,720,200, a 5.81 percent return on FVRB, a Net Income of $1,281,605, a TIER of 1.17 and DSC of 1.41.

26. SSVEC sought a revenue increase of $9,862,959, or 10.63 percent, from $92,825,281 to $102,688,240. Based on our allowed Test Year Expenses, the Cooperative's proposal would produce Operating Income of $17,583,159, for a 13.23 percent rate of return on FVRB, and yield Net Income of $11,144,564, an operating TIER of 2.67, and DSC of 2.32.

27. The Cooperative based its requested increase primarily on a goal to increase its equity to 30 percent of total capital by approximately 2016, and to meet the TIER and DSC requirements of its lender.

28. Staff recommended a revenue increase of $7,595,316, or 8.18 percent, from

$92,825,281 to $100,420,597. Staff's recommendation would produce Operating Income of $15,365,515, for an 11.56 percent rate of return on FVRB, yield Net Income of $8,926,940, a TIER of 2.34 and DSC of 2.12.

29. At the end of 2008, SSVEC's equity was 25.2 percent of total capitalization and was projected to fall to approximately 23 percent of total capitalization in 2009.[136]

30. The goal of increasing SSVEC's equity to 30 percent of total capitalization by approximately 2016 is reasonable.

31. The evidence supports the Staff's projection for equity growth.

32. Total revenues of $100,430,597 will allow the Cooperative to meet its lender's required financial ratios and achieve a 30 percent equity ratio in a reasonable period of time. This revenue level is an increase of $7,605,316 or 8.19 percent, over Test Year revenues; resulting in an 11.53 percent return on FVRB, which is reasonable under the circumstances of this case.

33. It is reasonable that until the Cooperative reaches total equity level of at least 30 percent of total capitalization, that it should not return capital credits greater than 25 percent of its Net Income in any year. Furthermore, until its next rate case, on May 1st of each year, the Cooperative should file an annual update of its equity projections, which should include an explanation of all assumptions and any deviations from the prior year's projections.

34. The Staff's proposed increase to customer charges is reasonable, and should be adopted.

35. The Staff's proposed Service Charges are reasonable and should be adopted.

36. It is reasonable to establish the base cost of power for SSVEC at $0.072127 per kWh.

37. Based on the revenue requirement approved herein, the average residential customer with usage of 728 kWh per month, would see a monthly increase of approximately $8.00, or approximately 9.0 percent, from $88.78 to approximately $96.82.

38. Staff's recommendations concerning DSM projects, the DSM adjustor and the REST as set forth herein and in the testimony of Steve Irvine are reasonable, and should be adopted.

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[136] Ex A-27.

39. It is fair and reasonable to set the initial DSM adjustor at $0.00088 per kWh.

40. Based on usage of 728 kWh per month, the average residential customer would see a charge of $0.64 per month attributable to DSM programs.

41. Staff's recommendations concerning the WFPCA as discussed herein are reasonable and should be adopted, except that DSM costs for 2008 and any prior years that are included in the WPFCA should not count toward the under-collected bank balance for determining when SSVEC must file for an increase in the WPFCA.

42. It is appropriate that future modifications to DSM programs and adjustments to the DSM adjustor shall be addressed by a future application in a separate docket, and SSVEC may make more than one application to re-set its DSM adjustor if the Cooperative believes it is necessary for the timely recovery of DSM program expenses.

43. It is reasonable that SSVEC be required to implement fuel procurement policies and to file its policies with Docket Control as a compliance item in this docket within a year of this Decision.

44. It is reasonable to defer a determination whether a fuel procurement prudency review is reasonable and necessary under the circumstances existing at the time of SSVEC's next rate case, taking into account the cooperative ownership structure.

45. SSVEC's proposed Service Conditions, as modified by Staff, and as set forth in Exhibit A-16 to this proceeding, are reasonable and should be adopted.

46. Staff's recommended TOU rate design (which does not include on-peak hours on weekends), is reasonable.

47. It is reasonable that in its next rate case filing, SSVEC shall file more detailed and conventional unbundled rates, which will not result in any incentive or disincentive for customers who want to choose competitive generation supplies.

48. Staff's recommendation that within 30 days of a Decision in this matter, SSVEC shall file with the Commission a tariff describing its bill estimation methodologies is reasonable.

## CONCLUSIONS OF LAW

1. SSVEC is a public service corporation pursuant to Article XV of the Arizona

Constitution and A.R.S. §§ 40-250 and 40-251.

2. The Commission has jurisdiction over SSVEC and the subject matter of the application.

3. Notice of the proceeding was provided in conformance with law.

4. The rates, charges, approvals and conditions of service approved herein are just and reasonable and in the public interest.

5. It is in the public interest to approve SSVEC's DSM programs as conditioned by Staff's recommendations in the Supplemental Testimony of Steven Irvine.

**ORDER**

IT IS THEREFORE ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. is hereby authorized and directed to file with the Commission, on or before August 31, 2009, revised schedules of rates and charges consistent with the discussion herein and a proof of revenues showing that, based on the adjusted test year level of sales, the revised rates will produce no more than the authorized increase in gross revenues.

IT IS FURTHER ORDERED that the revised schedules of rates and charges shall be effective for all service rendered on and after September 1, 2009.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. shall notify its customers of the revised schedules of rates and charges authorized herein by means of an insert, in a form acceptable to Staff, included in its next regularly scheduled billing.

IT IS FURTHER ORDERED that as long as its equity capital is less than 30 percent of total capitalization, Sulphur Springs Valley Electric Cooperative, Inc. shall not return any capital credits that total more than 25 percent of its Net Income/Net Margin in any given year.

IT IS FURTHER ORDERED that until its next rate case, on May 1 of each year, Sulphur Springs Valley Electric Cooperative, Inc. shall file an update of its equity projections, which report should include an explanation of all assumptions and any deviation from the prior year's projections.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. shall recover the costs of Commission-approved DSM programs through a DSM Adjustment Tariff as recommended by Staff in this proceeding.

IT IS FURTHER ORDERED that Commission-approved DSM costs should be assessed to all Sulphur Springs Valley Electric Cooperative, Inc. electric customers as a clearly labeled single line item per kWh charge on the customer bills.

IT IS FURTHER ORDERED that future modifications to DSM programs and adjustments to the DSM adjustor shall be addressed by a future application in a separate docket, and Sulphur Springs Valley Electric Cooperative, Inc. may make more than one application to re-set its DSM adjustor if the Cooperative believes it is necessary for the timely recovery of DSM program expenses

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. shall file its report on DSM program expenses semi-annually on March 1, for the period July through December, and September 1, for the period January through June.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. shall file the DSM program expense reports in Docket Control and shall redact any personal customer information, and that the DSM program expense reports shall include the following: (i) the number of measures installed/homes built/participation levels; (ii) copies of marketing materials; (iii) estimated cost savings to participants; (iv) gas and electric savings as determined by the monitoring and evaluation process; (v) estimated environmental savings; (vi) the total amount of the program budget spent during the previous six months and, in the end of year report, during the calendar year; (vii) the amount spent since the inception of the program; (viii) any significant impacts on program cost-effectiveness; (ix) descriptions of any problems and proposed solutions, including movements of funding from one program to another; and (x) any major changes, including termination of the program.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. should file its new proposed DSM adjustor rate with Docket Control by March 1st of each year, and that such filing be considered and adjudicated by the Commission in Open Meeting.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc.'s DSM adjustor rate shall be reset by Commission Order annually on June 1 of each year, and that the per kWh rate shall be based upon currently projected DSM costs for that year (the year for which the calculation is being made) adjusted by the previous year's over- or under-collection, divided by projected retail sales (kWh) for that same year.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc.'s new DSM adjustor rate shall become effective as directed by Commission Order.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc.'s Energy Efficient Water Heater Rebate program, is hereby approved, as modified by Staff's recommendations in this proceeding.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc.'s Commercial and Industrial Energy Efficiency Improvement Loan program is approved as a pilot-program for a period of 16 months, and that following the 12th month of program operation, Sulphur Springs Valley Electric Cooperative, Inc. make a filing detailing its experience with the program and a recommendation regarding continuation of the program.

IT IS FURTHER ORDERED that the proposed Energy Efficient New Home or Remodel Rebate program shall be denied, and Sulphur Springs Valley Electric Cooperative, Inc. shall discontinue offering any incentive related to the replacement of any heating or cooling appliance using an energy source other than electricity with an electric appliance in order to promote fuel switching.

IT IS FURTHER ORDERED that the Industrial Energy Efficient Improvement Loan program and Energy Efficient Improvement Loan Program shall be modified to be interest free.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc.'s initial DSM adjustor rate is $0.00088 per kWh, until further Order of the Commission.

IT IS FURTHER ORDERED that the prudently incurred costs associated with approved DSM programs, for the years 2008 and earlier, that have been factored into the WPFCA account balance shall remain in the WPFCA account balance.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. shall recover the costs of its Renewable Energy Standard Tariff by means of an REST Adjustor Mechanism and shall file with the Commission a REST tariff with conforming changes within 30 days of the effective date of this Decision.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. shall recover the costs of its purchased fuel and power used to provide service to its members in a Wholesale Power and Fuel Cost Adjustor mechanism, such adjustor to operate as discussed herein and in Staff's testimony, and which may only be increased upon Order of the Commission, but which my be decreased by Sulphur Springs Valley Electric Cooperative, Inc. without Commission Order.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. as a matter of compliance, shall docket by October 30, 2009, a report setting forth the manner and dates its shall conduct public forums in the communities served by the planned 69kV line and associated upgrades. This report shall also discuss the topics to be addressed at the public forums and the topics shall include, but not be limited to, addressing how renewable energy generation (in particular distributed generation) could be incorporated into the generation plans to serve the area covered by the planned 69kV line and associated upgrades.

IT IS FURTHER ORDERED that by July 30, 2010, Sulphur Springs Valley Electric Cooperative, Inc., as a matter of compliance, shall docket a report discussing the outcome of the public forums and also discussing how it plans to incorporate the reasonable and effective renewable energy proposals resulting from the public forums.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. as a matter compliance, shall docket by December 31, 2009, a feasibility study prepared by an independent third party that includes alternatives (including use of distributed renewable energy) that could mitigate the need for construction of Sulphur Springs Valley Electric Cooperative, Inc.'s proposed 69kV project. The feasibility study shall be available for discussion in public forums conducted by the Sulphur Springs Valley Electric Cooperative, Inc. in the impacted communities. A report and minutes from these public forums shall be docketed by Sulphur Springs Valley Electric Cooperative, Inc. no later than July 30, 2010.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. shall not commence construction of the referenced 69kV line until the public has had an opportunity to review and comment on the report and until further Order of the Commission.

IT IS FURTHER ORDERED that the Service Conditions, as set forth in Exhibit A-16 to this proceeding are hereby approved.

IT IS FURTHER ORDERED that within a year of the effective date of this Decision, Sulphur Springs Valley Electric Cooperative, Inc. shall file in this Docket, as a compliance item, its written fuel procurement policies as recommended by Staff.

*IT IS FURTHER ORDERED that within 30 days of the effective date of this Decision,* Sulphur Springs Valley Electric Cooperative, Inc. shall file for approval of a tariff describing its bill estimation methodology.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc. shall file revised line extension policies within 60 days of the effective date of the Order, for Commission approval which reflect a Schedule of Charges, a statement that quotes provided to customers will be itemized and procedures for refunding amounts to customers when additional customers connect to the line extension.

IT IS FURTHER ORDERED that Sulphur Springs Valley Electric Cooperative, Inc., shall file in this docket one year from the effective date of this Decision, and annually thereafter, a report detailing the total number of Residential TOU ratepayers and the cost savings or losses experienced by the participants in the Residential TOU plan. If, after two years from the effective date of this Decision, less than 10 percent of the eligible ratepayers are participating in Sulphur Springs Valley Electric Cooperative Inc.'s Residential TOU plan, we will require Sulphur Springs Valley Electric Cooperative, Inc. to file a plan for Commission approval, to increase participation in the Residential TOU plan to at least 10 percent.

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IT IS FURTHER ORDERED that in its next rate case, Sulphur Springs Valley Electric Cooperative, Inc. shall file detailed and conventional unbundled rates that do not provide incentive or disincentive for customers who want to choose competitive generation.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN | COMMISSIONER

COMMISSIONER | COMMISSIONER | COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 8th day of Sept., 2009.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT

DISSENT

SERVICE LIST FOR: SULPHUR SPRINGS VALLEY ELECTRIC COOPERATIVE, INC.

DOCKET NO.: E-01575A-08-0328

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